

Identification in First-Price and Dutch Auctions when the Number of Potential Bidders is Unobservable

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Abstract

Within the IPV paradigm, we show nonparametric identification of model primitives for first-price and Dutch auctions with a binding reserve price and auction-specific, unobservable sets of potential bidders.

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1 Introduction

Identification in auctions has been an active area of recent research in industrial organization. Beginning with the seminal contributions of Guerre et al. (2000) and Athey and Haile (2002), the literature has explored nonparametric identification of a variety of auction models under progressively weaker assumptions on observables.¹

We contribute to this literature by showing nonparametric identification for first-price auctions with a binding reserve price r where the set of potential bidders varies from auction to auction and is unobservable. It is unobservable because those potential bidders whose valuations are lower than the reserve price r do not bid (enter). The entry probability then is the probability that the bidder's valuation exceeds r . We assume independent private values (IPV). The model allows for ex-ante asymmetries among bidders. Specifically, we

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¹See also a recent book by Paarsch et al. (2006).

assume that bidders may belong to different groups.² We assume that only auctions that have attracted at least one actual bidder are observable.³

We show that the distribution of valuations is identified in the region above the reserve price, and the distribution of the numbers of potential bidders is also identified. Essentially, we treat the number of potential bidders as an auction-specific effect. As in Paarsch (1997) and Athey et al. (2004), our basic identifying assumption is that the distribution of bidders' valuations does not depend on the numbers of potential bidders.

To illustrate the idea of our identification method, consider a symmetric setting. (We allow asymmetry in our analysis.) Notice that in one special case the number of potential bidders is observable. This case occurs when the number of actual bidders is maximal, $n = \bar{N}$. If this is the case, we can identify the distribution of valuations *conditional on entry* using standard methods, as in Guerre et al. (2000). But the fundamental parameter of interest is the unconditional distribution. Our trick is to notice that, when the number of actual bidders is $n = \bar{N} - 1$ so that the distribution of bids $G(\cdot | n = \bar{N} - 1)$ is a mixture of two components. The first component is the distribution of bids conditional on the number of *potential* bidders $N = \bar{N}$, and the second is the distribution of bids conditional on $N = \bar{N} - 1$. The mixture weights are the probabilities of $N = \bar{N}$ and $N = \bar{N} - 1$, conditional on the number of *actual* bidders $n = \bar{N} - 1$. Using a theoretical results that the upper bounds of bid supports are ordered (also proved in the paper), we show that these mixture weights are identified. They in turn identify the entry probability for every bidder. Once this is shown, we are able to identify the distribution of N , despite the fact that only the auctions that have attracted at least one actual bidder are observable. Combining our approach with the methods in Berman (1963), and in Athey and Haile (2002), we extend our results to Dutch auctions where only the winning bids are observable.

Hu and Shum (2007), in a paper that is closely related and was concurrently written, consider identification and estimation of a model similar to ours. The main difference is that they allow the distribution of valuations to depend on the number of potential bidders. (Another difference is that they restrict attention to a symmetric model.) They show that identification nevertheless obtains provided an instrument is available that exogenously determines the number of potential bidders. Their methods are based on recent results in the literature on misclassified regressors and are different from ours.

Several other papers in the empirical auction literature are related to our paper. Paarsch (1997), in his study of the Small Business Forest Enterprise Program (SBFEP) in British Columbia, estimates that the average number of actual bidders is about 3.29. Due to non-participation caused by a binding reserve price, the number of potential bidders exceeds the number of actual bidders. But if one uses a crude measure of the number of potential bidders such as the number of firms registered in the district of the auction, the number of potential bidders could be as high as 185. Clearly, with this measure, one would substantially overestimate the level of potential competition in the majority of auctions. Paarsch (1997) adopts a clever parametric estimation strategy that is based on conditional likelihood and eliminates the need to estimate the number of potential bidders. However, his approach is limited to ascending-bid (English) auctions.

²This approach is adopted in Athey et al. (2004), Flambard and Perrigne (2006), Krasnokutskaya and Seim (2007) and Hubbard and Paarsch (2008).

³See Hendricks and Porter (2005) for a discussion of the empirical relevance of this assumption.

Most of the papers that estimated first-price auctions approached the measurement of potential competition empirically. In some cases, such a measure is readily available. For example, in highway procurement auctions conducted by state departments of transportation, the list of eligible firms is sometimes publicly released and can serve as a good proxy for potential competition (e.g. Li and Zheng (2006), Krasnokutskaya and Seim (2007) and Marmer et al. (2007)). In other cases, researchers have used geographic proximity as a basis for firm inclusion in the set of potential bidders (Athey et al. (2004), Hendricks et al. (2003)).

Since the structural auction estimates are sensitive to the measure of potential competition (Hendricks and Porter, 2005), another approach is to treat the number of potential bidders as a parameter to be estimated, as in Laffont et al. (1995). Ideally, this parameter would be auction specific, so a model for potential competition would be estimated jointly with the model of bidding. Nonparametric identification of the entire model is necessary as a foundation for such an approach, and our results provide such a foundation.

Song (2005) and Adams (2007) consider identification and estimation of eBay auctions with an unknown number of potential bidders. Similar to us, both papers use the identifying assumption that the distribution of bidders' valuations does not depend on the number of potential bidders N . But their methods are tailored for eBay auctions and are entirely different from ours. Song (2005) shows that the joint distribution of any two order statistics identifies the parent distribution. She then applies this result to eBay auctions, by arguing that in equilibrium, the second and third highest bidders bid truthfully. She develops a nonparametric estimator based on her identification result. Adams (2007) shows that, under certain additional assumptions, observing just the transaction price is sufficient for identification.

2 The model

We consider IPV first-price auctions. Bidders are ex-ante asymmetric: we assume that there are m groups of bidders. Within each group the bidders draw valuations from the same distribution F_i , but the distributions F_i may be different across the groups. The set of groups is denoted as $\mathcal{M} \equiv \{1, 2, \dots, m\}$. The number of potential bidders in group i is denoted as N_i , and we sometimes use the notation $N \equiv (N_1, \dots, N_m)$. We refer to such an auction as N -*auction*. Our most important identifying assumption is that the distribution of valuations does not depend on the composition of bidder groups. (In the symmetric case, this is equivalent to the requirement that the distribution of bidders' valuations does not depend on the number of potential bidders.)

Assumption 1 *The distributions of bidders' valuations do not depend on N , i.e. $\forall N, N' \in \mathbb{Z}_+^m$ with $N_i, N'_i > 0$ we have $F_i(v|N) = F_i(v|N') \equiv F_i(v)$.*

This assumption rules out cases when the decision to become a potential bidder is correlated with the would-be bidder's valuation, for example. We assume that each distribution F_i has the same support, denoted as $[\underline{v}, \bar{v}]$, and has density f_i which is bounded away from

zero on its support.⁴ In this setting, Maskin and Riley (2000) and Lebrun (1999) have shown existence and uniqueness of Bayesian-Nash equilibrium bidding strategies $B_i(\cdot|N)$.⁵ These results imply that bidders from the same group must use identical bidding strategies.

From the econometrician's point of view, N is randomly drawn from some probability distribution p and is unobservable. In other words, N is treated as an auction-specific effect. The support of p is denoted as S , i.e. $p(N) > 0$ if and only if $N \in S$. We also make the following assumption.

Assumption 2 *For every group $i \in \mathcal{M}$, there exists some $N \in S$ such that $N_i \geq 2$. More succinctly, $\cup_{N \in S} \{i : N_i \geq 2\} = \mathcal{M}$.*

Without this assumption, we cannot guarantee that equilibrium bidding strategies are strictly increasing on $[r, \bar{v}]$, at least in some auction, for all groups, so that identification of $F_i(v)$ for $v \in [r, \bar{v}]$ might fail.⁶

Nonparticipation in the auction is due to the existence of a binding reserve price $r \in (\underline{v}, \bar{v})$. We assume that the numbers of potential bidders in each auction are unobservable: only the bidders with valuations at least as high as the reserve price r submit serious bids. We treat non-serious bids as uninformative and ignore them. From now on, it will be assumed that every bidder submits a bid only if his valuation is at least r , thereby becoming an *actual* bidder. The decision to become an actual bidder is called the *entry decision*. Only the auctions that have attracted at least one actual bidder are assumed to be registered in the dataset.

We assume that in each auction, the econometrician observes the bid of every actual bidder. The identity of each bidder is also observable, implying that its group is known. This implies that the vector $n \equiv (n_1, \dots, n_m)$ of the numbers of actual bidders in each group, is observable if $\sum_{i=1}^m n_i > 0$. Denote the C.D.F. of bids from a group i bidder, *conditional on entry* and the vector of potential bidders N , as $G_i^*(\cdot|N)$ ($N_i > 0$). Since N is unobservable, the data do not reveal this C.D.F. They only reveal the C.D.F. of bids conditional on the numbers of actual bidders $G_i(b|n)$ ($n_i > 0$).

A bidder from group i becomes active if $v \geq r$, i.e. with probability $1 - F_i(r)$. Since bidders draw their valuations independently, the distribution of n conditional on N is multinomial, with probabilities

$$\pi(n|N) = \prod_{i=1}^m \binom{N_i}{n_i} [1 - F_i(r)]^{n_i} [F_i(r)]^{N_i - n_i} \quad (n \leq N). \quad (1)$$

These probabilities are not observable. The marginal probabilities of n are

$$\rho(n) = \sum_{N \in S} p(N) \pi(n|N).$$

⁴Identical supports is a standard assumption in the theoretical literature on asymmetric auctions. See e.g. Lebrun (1999).

⁵See also Bajari (2001).

⁶See Lebrun (1999) and our Appendix for details.

Since the econometrician only observes the auctions with at least one active bidder, the marginal probabilities are also unobservable; only the conditional probabilities

$$\rho^*(n) = \frac{\rho(n)}{1 - \rho(0)} \quad \left(\sum_{i=1}^m n_i > 0 \right) \quad (2)$$

are observable.

3 Main results

The primitives that we seek to identify are $F_i(\cdot)$ for every $i \in \mathcal{M}$, and $p(N)$ for every $N \in S$. Before we turn to our results, consider the case when N is observable. Then the distribution $G_i^*(\cdot|N)$ and the $p(N)$ are also observable, and we can identify $F_i(r)$ from e.g.

$$\Pr\{n_i = 1|N\} = N_i (1 - F_i(r)) F_i(r)^{N_i-1}.$$

The distributions $F_i(v|v \geq r)$ can be identified from first-order equilibrium conditions following the approach of Guerre et al. (2000).⁷ Denote inverse bidding strategies as $\xi_i(b|N)$. If $b > r$ and $N_i > 0$, the inverse bidding strategies $\xi_i(b|N)$ can be found from the first-order conditions⁸

$$\xi_i(b|N) = b + \left\{ \sum_{j=1}^m \frac{N_j \frac{d}{db} F_j(\xi_j(b|N))}{F_j(\xi_j(b|N))} - \frac{\frac{d}{db} F_i(\xi_i(b|N))}{F_i(\xi_i(b|N))} \right\}^{-1} \quad (3)$$

where

$$F_j(\xi_j(b|N)) = (1 - F_j(r)) G_j^*(b|N) + F_j(r) \quad \text{for every } j \in \mathcal{M}.$$

This leads to the identification of group i 's bidding strategy $B_i(v|N)$ for $v > r$, and consequently of the distribution of valuations $F_i(v|v \geq r) = G_i^*(B_i(v|N)|N)$. Since $F_i(r)$ is identifiable, so is $F_i(v)$ for $v \geq r$:

$$F_i(v) = [1 - F_i(r)] F_i(v|v \geq r) + F_i(r) \quad (v > r).$$

When N is unobservable, the distributions $G_i^*(\cdot|N)$ are in general also unobservable, but there are special cases in which they are observable. Let \bar{S} be the set of maximal elements of S , i.e.⁹

$$\bar{S} \equiv \{\bar{N} \in S : \nexists N \in S \text{ s.t. } \bar{N} < N\}.$$

A typical element of \bar{S} is denoted as \bar{N} . When the number of actual bidders is maximal, i.e. $n = \bar{N}$ for some $\bar{N} \in \bar{S}$, obviously $G_i^*(\cdot|n) = G_i(\cdot|n)$. Since the latter distribution is observable, $G_i^*(\cdot|\bar{N})$ is identifiable for all $\bar{N} \in \bar{S}$ and i such that $\bar{N}_i > 0$. These special cases are sufficient to cover every bidder because, clearly, $\cup_{\bar{N} \in \bar{S}} \{i : \bar{N}_i > 0\}$ is equal to

⁷See also the discussion in Athey and Haile (2005).

⁸For the derivation of (3), see Appendix.

⁹We use the convention that: for any two vectors x_1 and x_2 of the same dimension, $x_1 < x_2$ means $x_1 \leq x_2$ and $x_1 \neq x_2$.

$\cup_{N \in S} \{i : N_i > 0\}$, which is in turn equal to \mathcal{M} . Our discussion of the observable N case then implies that $F_i(v|v \geq r)$ are identified for all $i \in \mathcal{M}$.

It remains to show that $F_i(r)$ and $p(N)$ are identifiable. Denote the support of group i 's bid distribution in the auction with the number of potential bidders N as $[r, \bar{b}(N)]$. (Recall that, even though bidders draw their valuations from distributions that may be different, the upper bounds of the supports are common for all bidders.) Our identification proof will rely on the following lemma.

Lemma 1 $\bar{b}(N)$ is strictly increasing in N .

It is well known that Lemma 1 always holds in a symmetric model, i.e. when bidders draw their valuations from the same distribution. In the Appendix, we prove it in general. The set \bar{S} is identifiable because it is also the set of maximal numbers of actual bidders. The bounds $\bar{b}(\bar{N})$ for $\bar{N} \in \bar{S}$ are identifiable. It is because for $\bar{N} \in \bar{S}$, we observe $G(\cdot|\bar{N})$ and the bound $\bar{b}(\bar{N})$ is identified as the upper bound of the support of $G(\cdot|\bar{N})$. Our main result is the following proposition.

Proposition 1 Given Assumptions 1 and 2, $F_i(r)$ and $p(N)$ are identifiable.

Proof. It is convenient to denote the conditional distribution of $N \geq n$ given n as $\lambda(N|n)$. By Bayes rule,

$$\lambda(N|n) = \frac{\pi(n|N)p(N)}{\rho(n)}. \quad (4)$$

Fix an arbitrary group $i \in \mathcal{M}$. Pick an $\bar{N} \in \bar{S}$ such that $\bar{N}_i > 0$. We first show that $\lambda(\bar{N}|\bar{N}_{-i})$, where

$$\bar{N}_{-i} \equiv (\bar{N}_1, \dots, \bar{N}_{i-1}, \bar{N}_i - 1, \bar{N}_{i+1}, \dots, \bar{N}_m),$$

is identifiable.

Notice that

$$1 - G_i(b|n) = \sum_{N: N \geq n} \lambda(N|n) [1 - G_i^*(b|N)]. \quad (5)$$

Lemma 1 implies $\bar{b}(\bar{N}_{-i}) < \bar{b}(\bar{N}_i)$. Thus if $b \in (\bar{b}(\bar{N}_{-i}), \bar{b}(\bar{N}_i))$, we have

$$1 - G_i(b|\bar{N}_{-i}) = \lambda(\bar{N}|\bar{N}_{-i}) [1 - G_i^*(b|\bar{N})].$$

On the other hand, when $n = \bar{N}$, the sum in (5) contains only one term, equal to $1 - G_i^*(b|\bar{N})$. It follows that

$$\lambda(\bar{N}|\bar{N}_{-i}) = \lim_{b \uparrow \bar{b}(\bar{N})} \frac{1 - G_i(b|\bar{N}_{-i})}{1 - G_i^*(b|\bar{N})} \quad (6)$$

is identifiable.

We now show how to recover $F_i(r)$ from $\lambda(\bar{N}|\bar{N}_{-i})$. First note that

$$\begin{aligned}\pi(\bar{N}|\bar{N}) &= \prod_{i=1}^m [1 - F_i(r)]^{\bar{N}_i}, \\ \pi(\bar{N}_{-i}|\bar{N}) &= \bar{N}_i (1 - F_i(r))^{\bar{N}_i - 1} F_i(r) \cdot \prod_{j \neq i} [1 - F_j(r)]^{\bar{N}_j}, \\ &= \bar{N}_i \frac{F_i(r)}{1 - F_i(r)} \pi(\bar{N}|\bar{N}).\end{aligned}$$

Then from (4), taking into account (1),

$$\begin{aligned}\lambda(\bar{N}|\bar{N}_{-i}) &= \frac{\pi(\bar{N}_{-i}|\bar{N}) p(\bar{N})}{\rho(\bar{N}_{-i})} \\ &= \bar{N}_i \frac{F_i(r)}{1 - F_i(r)} \pi(\bar{N}|\bar{N}) \frac{p(\bar{N})}{\rho(\bar{N}_{-i})}.\end{aligned}$$

We can combine this equation with

$$\lambda(\bar{N}|\bar{N}) = \frac{p(\bar{N}) \pi(\bar{N}|\bar{N})}{\rho(\bar{N})} = 1$$

to eliminate $p(\bar{N})$. This yields

$$\frac{F_i(r)}{1 - F_i(r)} = \frac{1}{\bar{N}_i} \lambda(\bar{N}|\bar{N}_{-i}) \frac{\rho(\bar{N}_{-i})}{\rho(\bar{N})}. \quad (7)$$

From (2),

$$\frac{\rho(\bar{N}_{-i})}{\rho(\bar{N})} = \frac{\rho^*(\bar{N}_{-i})}{\rho^*(\bar{N})},$$

and therefore (7) implies

$$\frac{F_i(r)}{1 - F_i(r)} = \frac{1}{\bar{N}_i} \lambda(\bar{N}|\bar{N}_{-i}) \frac{\rho^*(\bar{N}_{-i})}{\rho^*(\bar{N})}. \quad (8)$$

Since the right-hand side of this equation contains only identifiable quantities, $F_i(r)$ is identifiable for each $i \in \mathcal{M}$.

Finally, we can recover $p(N)$ from the total probability equations. For $\alpha = 1 - \rho(0)$, the law of total probability implies the following system of linear equations for $p(N)$:

$$\alpha \rho^*(n) - \sum_{N: N \geq n} \pi(n|N) p(N) = 0. \quad (9)$$

Since $F_i(r)$ are identifiable, $\pi(n|N)$ are also identifiable; see (1). Formally, consider the above system for any $\alpha \in (0, 1)$. Write $p(N)$ as $P(N, \alpha)$ to make the dependency on α explicit. Since the probabilities $P(N, \alpha)$ enter the right-hand side of (9) only for $N \geq n$,

the system has a recursive structure that allows one to uniquely determine $P(N, \alpha)$ for all N . To see this most easily, we can use an induction argument. Begin with those $N \in \bar{S}$, we have

$$P(N, \alpha) = \frac{\alpha \rho^*(N)}{\pi(N|N)}. \quad (10)$$

Next, for any given $N \notin \bar{S}$, if $p(N', \alpha)$ are known for all $N' > N$, and we can determine $P(N, \alpha)$ from (9) according to

$$P(N, \alpha) = \frac{1}{\pi(N|N)} \times \left[\alpha \rho^*(N) - \sum_{N': N' > N} \pi(N|N') P(N', \alpha) \right]. \quad (11)$$

To determine α , note that as a solution of a liner system, $P(N, \alpha)$ is homogeneous of degree 1 in α , so that $P(N, \alpha) = \alpha P(N, 1)$. For $\alpha = 1 - \rho(0)$, the law of total probability implies

$$(1 - \rho(0)) \sum_{N \in S} P(N, 1) = 1,$$

Since $P(N, 1)$ are now known, the above equation uniquely determines $\rho(0)$. Therefore $p(N)$ is identified: $p(N) = (1 - \rho(0)) P(N, 1)$. Q.E.D.

4 Extension to Dutch auctions

In this section, we show that our result generalizes to Dutch auctions, where only the winning bid is observable. We continue to assume that the identities of actual bidders are observable. Fix an $\bar{N} \in \bar{S}$. Restrict attention to auctions with $n = \bar{N}$ and groups with $\bar{N}_i > 0$. Let W_i be the highest bid submitted from group i (with $\bar{N}_i > 0$). Let $W \equiv \max_i W_i$ be the winning bid. And let I be the identity of the winning group, i.e. $W = W_I$.

Our data directly reveals the joint distribution of (I, W) conditional on $n = \bar{N}$ (which also implies $N = \bar{N}$):

$$H_i(w|\bar{N}) \equiv \Pr(I = i \ \& \ W \leq w | n = \bar{N}).$$

Begin by recovering $H_i^*(\cdot|\bar{N})$ the C.D.F. of W_i conditional on $n = N = \bar{N}$. The set of functions $\{H_i(\cdot|\bar{N})\}$ is related to the set $\{H_i^*(\cdot|\bar{N})\}$ via the functional equations

$$H_i(w|\bar{N}) = \int_r^w \prod_{j \neq i} H_j^*(t|\bar{N}) dH_i^*(t|\bar{N}).$$

One can verify (see Berman (1963) and Athey and Haile (2002)) that the solution for $\{H_i^*(\cdot|\bar{N})\}$ is given by

$$H_i^*(w|\bar{N}) = \exp \left\{ - \int_w^\infty \left[\sum_j H_j(t|\bar{N}) \right]^{-1} dH_i(t|\bar{N}) \right\}. \quad (12)$$

Since the right-hand side of (12) contains only observable objects, $H_i^*(w|\bar{N})$ is identifiable. Now recall that $H_i^*(w|\bar{N})$ is the probability that all \bar{N}_i bidders in group i submit bids below w , conditional on $n = N = \bar{N}$. We have

$$H_i^*(w|\bar{N}) = [G_i^*(w|\bar{N})]^{\bar{N}_i},$$

which proves that $G_i^*(w|\bar{N})$ is identifiable for every $\bar{N} \in \bar{S}$ and every i such that $\bar{N}_i > 0$. This implies that $\xi_i(b|N)$ and therefore $F_i(v|v \geq r)$ are identifiable. The rest of the identification proof follows exactly parallel to that of Proposition 1.

5 Concluding remarks

We have shown that a first-price IPV auction model where nonparticipation is due to a binding reserve price, and the set of potential bidders is unobservable, is nonparametrically identified under weak assumptions. We do not develop a nonparametric estimation method. This may be an interesting direction for future research. On the other hand, from an empirical perspective, parametric assumptions are always used in some form. Our results provide a foundation for parametric estimation methods such as in Laffont et al. (1995) or Donald and Paarsch (1996), but with auction-specific number of potential bidders. Generalization to other private value auction models, e.g. with unobserved heterogeneity, either assuming affiliated values as in Li et al. (2002) or within the IPV paradigm as in Krasnokutskaya (2003), is also left for future research.

6 Appendix

This appendix sketches the derivations of equilibrium conditions, and proves Lemma 1. In order to simplify notations, we do not divide bidders into groups like we do in the text. The set of bidders is \mathcal{N} with $2 \leq |\mathcal{N}| < \infty$. Each bidder i draws his valuation v_i from the C.D.F. $F_i(\cdot)$.¹⁰

From here up to the proof of Lemma 2 below, we fix an \mathcal{N} -auction, and thus suppress the dependency of equilibrium objects on \mathcal{N} in our notation, e.g. we write bidder i 's inverse bidding strategy as $\xi_i(\cdot)$ rather than $\xi_i(\cdot|\mathcal{N})$. But when we prove Lemma 1, this dependency will become explicit.

For an \mathcal{N} -auction, bidder i solves

$$\max_b (v_i - b) \prod_{j \neq i} F_j(\xi_j(b)).$$

The first-order conditions are

$$\frac{1}{\xi_i(b) - b} = \sum_{j \neq i} \psi'_j(b) \tag{13}$$

where $\psi_j(b) \equiv \log F_j(\xi_j(b))$.

¹⁰Clearly, from the theoretical point of view the setting here is equivalent to the one we use in the text, although they are different from the econometrician's point of view.

Formula (3) in the text follows from (13).

Sum (13) over i and then divide through by $|\mathcal{N}| - 1$:

$$\frac{1}{|\mathcal{N}| - 1} \sum_j \frac{1}{\xi_j(b) - b} = \sum_j \psi'_j(b). \quad (14)$$

Subtract (13) from (14), we have

$$\psi'_i(b) = \frac{1}{|\mathcal{N}| - 1} \left[\sum_j \frac{1}{\xi_j(b) - b} - \frac{|\mathcal{N}| - 1}{\xi_i(b) - b} \right].$$

The above equation holds for $b \in (r, \bar{b}]$ where \bar{b} is the equilibrium maximum bid. Therefore for all $b \in (r, \bar{b}]$

$$\xi'_i(b) = \frac{F_i(\xi_i(b))}{(|\mathcal{N}| - 1) f_i(\xi_i(b))} \left[\sum_{j \neq i} \frac{1}{\xi_j(b) - b} - \frac{|\mathcal{N}| - 2}{\xi_i(b) - b} \right]. \quad (15)$$

The unique equilibrium is completely characterized by differential equations (15) and the following boundary conditions:¹¹

$\xi_i(r+) \geq r$ for all i , and $\xi_i(r+) = r$ except possibly one bidder

$\xi_i(\bar{b}) = \bar{v}$ for all i .

The proof of Lemma 1 will need the following result.

Lemma 2 *If $|\mathcal{N}| \geq 3$, $i \in \mathcal{N}$, $k \in \mathcal{N}$, and $i \neq k$, then for all $b \in (r, \bar{b}]$,*

$$\xi'_i(b) < \frac{F_i(\xi_i(b))}{(|\mathcal{N}| - 2) f_i(\xi_i(b))} \left[\sum_{j \neq i, k} \frac{1}{\xi_j(b) - b} - \frac{|\mathcal{N}| - 3}{\xi_i(b) - b} \right].$$

Proof. From $i \neq k$, we can rewrite (15) and get

$$\psi'_i(b) = \frac{1}{|\mathcal{N}| - 1} \left[\sum_{j \neq i, k} \frac{1}{\xi_j(b) - b} - \frac{|\mathcal{N}| - 3}{\xi_i(b) - b} + \left(\frac{1}{\xi_k(b) - b} - \frac{1}{\xi_i(b) - b} \right) \right]. \quad (16)$$

From (13),

$$\frac{1}{\xi_k(b) - b} - \frac{1}{\xi_i(b) - b} = \psi'_i(b) - \psi'_k(b).$$

Substitute this into (16) and solve for $\psi'_i(b)$:

$$\psi'_i(b) = \frac{1}{|\mathcal{N}| - 2} \left[\sum_{j \neq i, k} \frac{1}{\xi_j(b) - b} - \frac{|\mathcal{N}| - 3}{\xi_i(b) - b} - \psi'_k(b) \right].$$

¹¹See Lebrun (1999) for details.

Since $\xi'_k(b) > 0$ for all $b \in (r, \bar{b}]$ and hence $\psi'_i(b) > 0$ as well, we get the result.¹² Q.E.D.

Now we can prove Lemma 1.

Proof of Lemma 1. It suffices to prove $\bar{b}(\mathcal{N}) > \bar{b}(\mathcal{N} \setminus \{k\})$ for all \mathcal{N} with $2 \leq |\mathcal{N}| < \infty$. It is trivial if $|\mathcal{N}| = 2$, so suppose $|\mathcal{N}| \geq 3$. Suppose by the way of contradiction that $\bar{b}(\mathcal{N}) \leq \bar{b}(\mathcal{N} \setminus \{k\})$.

Step 1: We claim that, for small enough $\varepsilon > 0$, we have $\xi_i(b|\mathcal{N}) > \xi_i(b|\mathcal{N} \setminus \{k\})$ for all $b \in (\bar{b}(\mathcal{N}) - \varepsilon, \bar{b}(\mathcal{N}))$ and all $i \in \mathcal{N} \setminus \{k\}$.

This claim is obviously true if $\bar{b}(\mathcal{N}) < \bar{b}(\mathcal{N} \setminus \{k\})$. If $\bar{b}(\mathcal{N}) = \bar{b}(\mathcal{N} \setminus \{k\}) = \bar{b}$, it can be seen from

$$\xi'_i(\bar{b}|\mathcal{N}) = \frac{\bar{v} - \bar{b}}{(|\mathcal{N}| - 1) f_i(\bar{v})} < \frac{\bar{v} - \bar{b}}{(|\mathcal{N}| - 2) f_i(\bar{v})} = \xi'_i(\bar{b}|\mathcal{N} \setminus \{k\}).$$

Step 2: We claim that $\xi_i(b|\mathcal{N}) > \xi_i(b|\mathcal{N} \setminus \{k\})$ for all $b \in (r, \bar{b}(\mathcal{N}))$ and all $i \in \mathcal{N} \setminus \{k\}$.

Suppose not. Then going from $\bar{b}(\mathcal{N})$ downward, Step 1 implies that there is a first (largest) point $b^* \in (r, \bar{b}(\mathcal{N}))$ such that $\xi_{i^*}(b^*|\mathcal{N}) = \xi_{i^*}(b^*|\mathcal{N} \setminus \{k\})$ for some $i^* \in \mathcal{N} \setminus \{k\}$. Since b^* is the first point, we also have $\xi_j(b^*|\mathcal{N}) \geq \xi_j(b^*|\mathcal{N} \setminus \{k\})$ for all $j \in \mathcal{N} \setminus \{k\}$. Then it is easy to verify that Lemma 2 implies $\xi'_{i^*}(b^*|\mathcal{N}) < \xi'_{i^*}(b^*|\mathcal{N} \setminus \{k\})$. But then $\xi_{i^*}(b^* + \varepsilon|\mathcal{N}) < \xi_{i^*}(b^* + \varepsilon|\mathcal{N} \setminus \{k\})$ for small $\varepsilon > 0$, contradicting to the definition of b^* .

Step 3: It follows from Step 2 and (13) that for each $i \in \mathcal{N} \setminus \{k\}$ and each $b \in (r, \bar{b}(\mathcal{N}))$,

$$\sum_{j \in \mathcal{N} \setminus \{i, k\}} \psi'_j(b|\mathcal{N} \setminus \{k\}) > \sum_{j \in \mathcal{N} \setminus \{i\}} \psi'_j(b|\mathcal{N}) > \sum_{j \in \mathcal{N} \setminus \{i, k\}} \psi'_j(b|\mathcal{N}).$$

Integrate over $(r, \bar{b}(\mathcal{N}))$ and notice that $\psi_j(\bar{b}(\mathcal{N})|\mathcal{N}) \geq \psi_j(\bar{b}(\mathcal{N})|\mathcal{N} \setminus \{k\})$ for all j ,

$$\sum_{j \in \mathcal{N} \setminus \{i, k\}} \log F_j(\xi_j(r + |\mathcal{N}|)) > \sum_{j \in \mathcal{N} \setminus \{i, k\}} \log F_j(\xi_j(r + |\mathcal{N} \setminus \{k\}|)) \quad \forall i \in \mathcal{N} \setminus \{k\}.$$

Therefore, for each $i \in \mathcal{N} \setminus \{k\}$, there is a $j \in \mathcal{N} \setminus \{i, k\}$ such that $\xi_j(r + |\mathcal{N}|) > \xi_j(r + |\mathcal{N} \setminus \{k\}|)$. It follows that $\xi_j(r + |\mathcal{N}|) > \xi_j(r + |\mathcal{N} \setminus \{k\}|) \geq r$ holds for at least two distinct j 's in $\mathcal{N} \setminus \{k\}$, contradicting the boundary condition. Q.E.D.

¹²The result that $\xi'_k(b) > 0$ is stronger than strict monotonicity of ξ_k (since ξ_k might be 0 at isolated points). For its proof, see Lebrun (1997) Lemma A2-2.

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